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FM AMEMBASSY RIGA
TO RUEHC/SECSTATE WASHDC PRIORITY 5383
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000701

NOFORN
SIPDIS

E.O. 12958: DECL: 11/17/2018
TAGS: EFIN PGOV LG
SUBJECT: POLITICS AND THE PAREX BAILOUT

REF: A) RIGA 690 B) RIGA 298

Classified By: Ambassador Charles W. Larson. Reason: 1.4 (d)

¶1. (C/NF) Summary: We are keeping a close eye on the implementation of the government bailout of Parex to ensure that politics does not interfere in the proper implementation of the agreement to ensure maximum benefit and minimum risk for the taxpayers of Latvia. Parex has been a political player in Latvia for years and the owners are likely owed favors by many in power. The structure of the deal can be seen to offer some benefit to the former owners. At the same time, the size of its depositor base makes it a tempting target for politically connected individuals. Signs of political interference so far are mixed and it's not easy to separate fact from conspiracy theory. The handling of the Parex case will be a key indicator of how Latvia's leadership views the intersection of politics and economics. End summary.

¶2. (U) When Andris Skele founded the People's Party in the late 1990's, he claimed that no political decision was made in Latvia without the input of Ventspils mayor Aivars Lembergs and Parex President Valery Kargin. When Ainars Slesers entered politics, he said he would fight against the oligarchs - Lembergs, Skele and Kargin. Today, these four men are considered to be the leading oligarchs in Latvia. Kargin and his partner, Viktor Krasovickis, took one of the first currency exchange operations in the USSR and built it into a bank in newly independent Latvia where people from the former Soviet Union could put their money and feel safer than in their own countries, while taking advantage of Latvia's proximity and the relevant language and cultural knowledge. Parex unabashedly trumpeted this with its slogan "We're closer than Switzerland." Along the way, Parex was (when it was legal) a major donor to political parties, especially Latvia's Way (to which PM Godmanis belongs) and Fatherland and Freedom (a member of the coalition). More recently, Parex has been alleged to fund the ethnic-Russian oriented Harmony Center party. Parex's political interest does not appear to have been a particular policy agenda but ensuring the greatest economic benefit for the bank, both through access to government business and ensuring less stringent regulation of the bank's operations.

¶3. (C/NF) The question that concerns us is what role politics played in the government's decision to bail out the bank and in the structure of that bailout. Three elements of the decision draw particular attention in this regard -- when the decision was taken, the structure of the decision, and the terms of future oversight of the bank. Irena Krumane, head of the regulatory agency FCMC, indicated her own concerns about the timing of the process in our Nov. 10 meeting with her. She said that Parex had gone to the Prime Minister and others in government to seek assistance sometime in October. This at a time when the FCMC was heavily auditing Parex and possibly after the FCMC had in fact instructed Parex to stop lending. Krumane indicated her dismay that the bank was telling the FCMC that all would be fine with the bank's

finances while simultaneously appealing for government help. While she did not say it specifically, Krumane indicated that the government officials approached by Parex did not immediately inform the FCMC of the approach. If so, it is worrying that the government and regulator would not be working hand in glove at every step of the way in an operation like this.

¶5. (C/NF) The structure of the deal also raises concerns. First of all, why bail out at all? Martins Bondars, head of Latvijas Krajbanka and former Chief of Staff to President Vike-Freiberga, told us that when it was clear that Parex was in trouble several other banks made known to the government their willingness to immediately step in to acquire shares in the bank and inject liquidity, if the state would guarantee Parex's syndicated loans (which the government did for all banks in Latvia on November 5). The government ignored these offers, which likely would have removed Kargin and Krasovickis completely from the board, and went with the bailout Second, why buy only 51% of the shares? Krumane told us that she pushed for the government to buy out the full 85% ownership stake of Kargin and Krasovickis but that PM Godmanis personally insisted on the lower amount. Paul Raudseps, editorial page editor of Diena and frequent critic of Parex's political influence, argued that it made some sense to leave the two with some influence because they have personal relations with many of the bank's largest non-resident depositors. In that regard, Raudseps argued, keeping them around would be essential for stopping further deposit flight from the bank. But Raudseps was also critical of the terms of the deal, which have not been made fully public. In particular, Krasovickis told Diena that under the

agreement he and Kargin can buy back their shares for 4 Lats plus the amount of money the government injects into Parex plus interest. However, this cannot be verified as the government claims that the agreement cannot be made public due to European Commission rules. The Commission office here tells us that they urged the agreement not be made public until it as approved in Brussels, in case changes were needed. As commission approval draws near, the GOL is beginning to claim that proprietary information concerns prevent release of the full text of the document. So, we are unable at this time to confirm if the buy back provision is in fact included in the agreement and, if so, what its exact terms are. The final concern with the structure of the deal is that, when first announced, we were told that Kargin and Krasovickis had to put their personal assets up as collateral for the government injection of funds, in effect as collateral that the bank's situation is as advertised. We already reported that Krumane had concerns about the effectiveness of that. We now know that Kargin and Krasovickis actually have few assets of their own, most belonging to companies or to relatives. In fact, some assets, notably two very valuable Maybach cars, were transferred to holding companies just a few days prior to the signing of the deal. It is unclear to us at this point that the government could recoup any losses in any kind of timely fashion through these assets.

¶6. (C/NF) The final area of concern relates to who else may be seeking to profit from Parex's situation. Suspect number one in the Riga rumor mill is Andris Skele. Evidence to date in this regard is slim, but growing. Diena reports that Skele participated in some of the meetings at the ministry of finance where the deal was planned, something that Finance Minister Slakteris (also from People's Party) does not deny. What is also worrying is the structure of the oversight of the bank. Parex has been placed under the state owned mortgage bank, which is closely linked with the People's Party. More worrying is that Ministry of Finance State Secretary Martin Bicevskis could be assigned to oversee the bank's operations. Bicevskis is far more notable for his loyalty to the People's Party than for his financial skills (ref b). Asked about his role, both Krumane (his predecessor

at the finance ministry) and Bondars were evasive. When asked more specifically if Bicevskis role increased the possibility of political games being played both responded along the lines of "you said it, not I, but you make a very good point." On November 13, the Latvian parliament adopted on fast track a bill to amend the law on conflicts of interest for state officials. The sole purpose of this legislation seems to be to allow Bicevskis to remain at Finance while also running the bank. Although it is clear that People's Party is playing some role in all of this, it is unclear what that role is. Are they fronting for others, perhaps a Russian bank, that want to buy Parex, or do they have a deal with Kargin and Krasovickis to help them get back their shares as quickly and cheaply and possible?

¶7. (C/NF) Comment: We lack enough information and insight to make a final judgment, but there is no question that there is a high probability of political considerations outweighing sound financial or economic decisions in the case of Parex. Given the history of Parex, these questions were inevitable, but there appear to be additional grounds for concern. It may well be that leaving Kargin and Krasovickis with some role is important to keeping the biggest depositors happy. But it certainly looks like they are getting some favored treatment and not being held accountable for their management of the bank. And the government's unwillingness to make public the full text of the agreement, even acknowledging the need to protect some proprietary information, only heightens suspicions that the deal is not as it seems. Add in oversight by a person known much more for his political loyalties than for his financial knowledge and you have a number of worrying signs. If Latvia cannot manage a serious situation like this without thinking first about the personal finances of senior officials and political favors for key backers, then the situation with corruption in this country is worse than we feared.
LARSON